UNITED NATIONS

TD

United Nations Conference on Trade and Development

Distr.
GENERAL

TD/B/42(1)/8
3 July 1995

Original: ENGLISH

TRADE AND DEVELOPMENT BOARD
Forty-second session
First Part
Geneva, 11 September 1995
Item 4 of the provisional agenda

UNCTAD'S ASSISTANCE TO THE PALESTINIAN PEOPLE

Developments in the economy of the occupied Palestinian territory

Report by the UNCTAD secretariat

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GE.95-52294 (E)

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Preface

1. In accordance with the provisions of Conference resolution 146 (VI), and the Cartagena decision and General Assembly decision 47/445 on UNCTAD's assistance to the Palestinian people, this report presents the findings resulting from monitoring and investigating developments in the economy of the occupied Palestinian territory, 1/ especially during the period July 1994-June 1995. Along the lines of annual reports prepared by the UNCTAD secretariat on the subject since 1985, this report examines recent developments affecting the Palestinian economy and progress in the work of the secretariat on assistance to the Palestinian people.

2. Political developments in the region continue to bear heavily on most aspects of economic activity in the territory. In particular, the past year witnessed the implementation of the 1993-1994 Israel-Palestine accords, 2/ the gradual assumption of responsibilities by the Palestinian Authority, and ongoing negotiations to extend Palestinian self-government from Gaza and Jericho to the remainder of the West Bank. These issues and related developments have preoccupied the concerned parties and have become intertwined with the course of Palestinian economic development and future prospects. Since 1993, the achievements of the Middle East peace process have emerged as the only concrete and workable basis on which to rebuild the Palestinian economy within a framework of peaceful cooperation with Israel and its Arab neighbours. However, needs are great, public expectations of this process are high, but implementation has been slow. For the Palestinian people, many of the expected economic gains from the peace process have yet to be manifested as readily attainable goals.

3. Notwithstanding the obstacles that have faced the peace process and the revival and reconstruction of the Palestinian economy, substantial progress has been made and the longer-term prospects for economic and social development appear better than ever before. An agreed and defined framework for economic policy-making is in place, the requisite institutional and operational arrangements have begun to take shape, international emergency-assistance programmes have started to operate, and the conditions for significant private investment initiatives have improved noticeably, including possibilities for Israeli-Palestinian cooperation. The consolidation of these positive trends, coupled with the resolution of outstanding political issues should improve the conditions for sustained Palestinian economic and social development.

4. Accordingly, Part I of this report briefly reviews recent major economic developments in the Palestinian territory, including available data on economic performance. Particular attention is focused on recent trends in private investment in the Palestinian economy. Part II presents the summary of findings of the UNCTAD secretariat research project on medium- and long-term prospects for sustained development of the Palestinian economy. Part III reviews the progress made in the work of the secretariat on assistance to the Palestinian people during the period under review. In view of the pressing needs of the Palestinian Authority, attention has been specially focused on the secretariat's programme of technical cooperation activities in support of Palestinian trade, investment and related services, implementation of some of which began as of mid-1995.

Part I

RECENT DEVELOPMENTS IN THE PALESTINIAN ECONOMY (1993-1995), WITH SPECIAL REFERENCE TO TRENDS IN PRIVATE INVESTMENT

A. The policy environment affecting the Palestinian economy

1. Implementation of Israel-Palestine economic agreements

5. As was noted by the secretariat in 1994, the Israel-Palestine accords of 1993-1994 attach a high premium to economic and social development, both as means and ends of the peace process. 3/ The prospects which were revealed as a result of these accords, and the ambitious economic and social goals and reconstruction programmes they entail, have placed a heavy implementation burden on those concerned to deliver tangible results within a short time-frame. Under the sustained pressure of political and security turbulence throughout the year, policy makers and negotiators have made progress in most areas embodied by the peace accords, while negotiations continue on unresolved issues. Of major significance in this regard is the extension of the interim arrangements to the rest of the occupied territory, agreement on which is intended for July 1995. Only after the implementation of all interim arrangements, including Israeli redeployment in the West Bank and Palestinian elections, are the complex "final status" issues scheduled to be negotiated (as of 1996). Thus, the impact of the recent economic accords is best assessed relative to both the actual progress made and the distance yet to be covered, as well as in comparison to the economic decline of the pre-1993 period.

6. The major features of the five-year interim phase agreed in the Israel-Palestine Declaration of Principles have become apparent since the May 1994 Gaza and Jericho Agreement. The Palestinian Authority (PA) 4/ has assumed civil, political, security and economic authority in Gaza and Jericho, and its main institutions have begun to function. The principles and implementation agreements of the Israel-Palestine Protocol on Economic Relations have been observed. In December 1994, the PA assumed responsibilities in five sectors in the West Bank, namely education, health, welfare, tourism and taxation. 5/ In May 1995, it was agreed to transfer responsibilities to the PA in other sectors in the West Bank, including agriculture, energy and statistics. Notable progress was made in the areas of trade, banking and public finance.

7. For the first time, the principle of free trade of manufactured and most agricultural commodities between the territory and Israel has been accepted, and a framework now exists for expanding and diversifying Palestinian trade with Arab partners. By mid-1995, over 40 branches of 12 Arab and Palestinian banks had opened in the territory, encouraging a significant increase in business start-ups. This accompanied the reactivation of the fiscal system, including revenue collection and public expenditure rationalization. In 1995, the Value Added Tax (VAT) monthly clearance arrangement between Israel and the PA was initiated, with widening coverage and compliance reported; a net surplus of VAT payments due to the PA helped to boost Palestinian government revenues. 6/ For the period from May 1994 until March 1995, over $50 million in net VAT revenue on trade with and via Israel was owed to the PA

(for the Gaza Strip since May 1994, and for the West Bank since December 1994) along with $22 million in fuel excise taxes paid by Palestinian consumers to Israeli suppliers. 7/ By May 1995, arrangements for reimbursing the PA were complete and first payments were made by Israel. 8/

8. Despite these and other achievements, several impediments continued to hinder the smooth functioning of the new economic policy framework until mid-1995. As noted, the implementation of some important parts of the interim accord was to take place by mid-1995, including the passage arrangements for people and goods between the self-government areas, Israel and the rest of the world. The limited empowerment of the PA to date and the delay in the extension of self-rule arrangements have further complicated the tasks of economic management and have delayed the process of economic policy reform and restructuring. In addition, the development of institutional mechanisms and regulatory arrangements needed to implement the economic accords has been slow. The challenges of institution-building in a fragmented legal, political and geographical context have been formidable. Policy makers and public opinion remained focused for much of the period on activating the international emergency-assistance programme. This distracted attention from other issues, and the slow pace of the international aid programme has discouraged expedient implementation of policy reforms and new private-sector business ventures (see below).

9. Israeli measures motivated by security considerations also have had an adverse impact on the Palestinian economy over the period under investigation. In particular, repeated closures of the Gaza Strip and the West Bank for security reasons have greatly reduced the number of Palestinian workers allowed into Israel, have caused a sharp fall in income from work in Israel, blocked trade flows to and from the territory, depressed prices of local goods and dampened investment activities and immediate prospects. The closures adversely affected much of the Gaza Strip population, as well as external trade links which are dependent on free access to markets in Israel, the West Bank and abroad. 9/ After several months of closure, arrangements were announced in May 1995 to facilitate the movement of labour and goods to and from the territory. 10/ It was expected that the Joint Economic Committee would convene in mid-1995 to revise some provisions of the Israel-Palestine economic accords in light of new Palestinian needs. 11/

2. Prospects for Palestinian-Arab economic cooperation

10. As has been emphasized in previous secretariat reports and studies, the Arab regional dimension features prominently in most Palestinian economic and social sectors, in particular the vital role of trade with and through Jordan in improving Palestinian development prospects. In January 1995, Jordan and Palestine signed several "framework agreements" on trade and other economic relations, 12/ which call for advanced cooperation, as compared to more circumspect relations that prevailed since 1988. Detailed protocols for the implementation of some of these agreements were signed in May 1995, including one agreement covering merchandise trade between Jordan and the territory. The trade protocol provides a structured incentive scheme based on tariff exemptions and reductions to promote Jordanian-Palestinian trade in the interim period, within the ceilings and broad commodity groupings identified in the Israel-Palestine economic accords of 1994. Two lists of a total

of 75 Jordanian manufactured exports have been identified for exemption from Palestinian customs duties; another list exempts 27 Palestinian manufactured exports from Jordanian customs duties and other levies and taxes (of a similar effect, except for local production and sales taxes); and a fourth list, however, exempts 14 Palestinian manufactured exports only from Jordanian customs duties. Agricultural trade between the two parties is exempt from duties, levies and taxes, and will be regulated by a seasonal schedule established by a joint committee of experts. Arrangements have been agreed for certification of origin of Palestinian and Jordanian exports, while trade fairs are planned to promote exports on both sides. Further negotiations will tackle unresolved issues of transit trade and Palestinian imports of Jordanian petrochemical products.

11. Some progress was also made in developing Egyptian-Palestinian economic relations, though final implementation agreements have yet to be signed. At the most recent ministerial meeting, a number of issues of mutual concern were discussed. 13/ These included: the prospects for increasing trade through mutual preferential concessions, along the lines of the Global System of Trade Preferences among Developing Countries (GSTP), to which both Egypt and Palestine have adhered; opening the Rafah border point to merchandise trade between the territory and Egypt; establishing a border industrial export-processing zone and a joint duty-free zone; organizing trade fairs; facilitating Palestinian imports of Egyptian cement; and a Palestinian request to lease a pier at a nearby Egyptian seaport to expedite merchandise trade flows to and through the territory. In the meantime, PA-sponsored efforts to open markets in the Arab Gulf States to Palestinian manufactured and agricultural exports have produced some results with a Palestinian trade fair planned for the first time in Dubai in mid-1995. Saudi Arabia announced in 1995 that imports of "Palestinian national products" may now resume, after an interlude of several years. 14/ The ultimate success of such important initiatives depends, inter alia, on satisfactory transit arrangements for Palestinian exports via neighbouring countries. Early elaboration and implementation of Palestinian-Arab agreements is something to which government officials and the business community in the territory and the region attach great importance in the light of the political and economic developments unfolding at the regional and international levels. Until clear and workable arrangements have been established, covering trade and wider economic relations between the territory and its Arab neighbours, the prospects for reorganizing and reviving Palestinian trade with traditional markets are considered limited.

3. The new Palestinian economic and social institutional framework

12. The new policy environment since the Israel-Palestine accords has also been manifested in the emergence of a unique Palestinian institutional framework for economic policy-making and management at the public- and private-sector levels. The interim phase provides a useful opportunity for the Palestinian people to build their new governmental and non-governmental institutions gradually and in phases. This process aims at striking a balance between current realities, actual needs and aspirations and the provisions of agreements with Israel and other parties. An important asset in the Palestinian development process since 1993 has been the gradual transformation

of the Palestinian social fabric in the territory, whereby the PA, along with a wide cross-section of the Palestinian people (including the Palestinian expatriate community), are embarking on a nation-building exercise in the Palestinian territory for the first time. Success in this process of matching and merging Palestinian human resources within a new public and private institutional framework will provide an important contribution to consolidating the gains of the peace process and to ensuring a smooth transitional period.

13. The most concrete example of this process since 1994 is noted in the assumption of self-government responsibilities by the PA itself. The PA has so far established 16 ministries, alongside several governmental agencies with official status. Though the PA exercises full powers in the Gaza and Jericho areas, it has already assumed authority in other sectors in the West Bank, and expects to have eventually jurisdiction over the entire Palestinian population in the territory. In its first year of operation, the PA has been preoccupied with preparing work programmes, securing resources, drafting legislation and regulations, staffing ministries and mobilizing the first-ever Palestinian Government in the territory in the reconstruction process. While in some cases, clear and defined lines of authority and specialization have not always been apparent, and the influence and effective authority of government departments remains limited by subjective and objective constraints, the PA has made important strides in laying the foundation for a Palestinian Government dedicated to public service, transparency and efficiency.

14. In tandem with the activation of the government sector, there have been notable developments in the fabric of Palestinian civil society. A broad network of Palestinian non-governmental organizations (NGOs) has been established since the 1980s providing a range of development services under conditions of occupation. The growing involvement of the PA in the provision of social services and its corresponding claim on scarce domestic and international resources has allowed for a reappraisal of the role of NGOs, and their relation to government authorities, as well as the beginning of a rationalization of their activities. Accordingly, NGOs are called upon to define carefully their specialized areas of activity in a manner that responds to agreed development priorities and complement and bolster the tasks of the Government. The rich experience of the NGO network, especially during the intifada, and their strong roots in Palestinian civil society, suggest that they can make an important contribution to reconstruction and development efforts. Meanwhile, the actual and potential role of the private enterprise sector in building a new Palestinian economy has acquired growing prominence. In an increasingly liberal and promising business environment, Palestinian domestic and expatriate entrepreneurs have been encouraged to consolidate and expand existing facilities and institutions, while also initiating new ventures with significant capital commitments (see section C below). The shared experience and resources of the Palestinian private sector, with its vibrant history in the region, are, for the first time, merging in new institutional forms dedicated to developing the Palestinian economy within a context of cooperation and public trust.

4. Multilateral and bilateral development assistance programmes

15. In October 1993, a major international programme was launched to aid Palestinian reconstruction and development efforts. Pledges made by 38 bilateral and multilateral donors totalled some $2.4 billion for the period 1994-1998, of which $1.5 billion was in the form of concessionary grants and $900 million in loans and guarantees. 15/ Accordingly, an Emergency Assistance Programme (EAP) for 1994-1996 was agreed with the PA, with an expenditure target of $1,235 million, comprising public investments of $600 million, private-sector support of $300 million, start-up expenditure support for central government and NGOs of $260 million, and some $75 million in technical assistance. Implementation of the programme is managed by an Ad Hoc Liaison Committee (AHLC) of donors, the World Bank (serving as the secretariat) and the Palestinian Economic Council for Development and Reconstruction (PECDAR). The sectoral and other criteria established for the EAP have been adhered to, but various political, and technical considerations (on the donor and recipient sides) have resulted in slower and less coherent programme delivery than expected. 16/ This in turn has been a cause for mounting concern for the PA which had envisaged a rapid delivery of international aid as an important component of building public confidence in the peace process and expediting economic and social recovery.

16. After the first year of implementation (1994), some visible and concrete manifestations of initial progress in implementing the international aid programme could be noted, though some problems remained to be addressed. While total pledges for 1994 amounted to $827 million (the bulk of which was for investment projects and recurrent budgetary expenditures), total 1994 disbursements amounted to only $239 million, equivalent to 33 per cent of commitments. When compared to needs identified in the EAP, actual disbursements in 1994 left 54 per cent of identified investment needs unaddressed and 32 per cent of recurrent expenditures uncovered. Preliminary data for 1995 indicate prospects for improved programme delivery: total 1995 pledges amount to over $520 million, with assessed EAP 1995 needs amounting to around $400 million.

17. To the extent that the PA and the local economy are capable of increasing absorptive capacity, undisbursed commitments for 1994 and the pledged assistance for 1995 should make a clear contribution to reviving the Palestinian economy. Lessons learned in 1994 should help to expedite the delivery of pledged aid and to avoid some of the problems already experienced. The latter have been reported to include: 17/ sectoral mismatching between commitments and needs owing to oversubscription of some sectors and inadequate donor coordination; changing sectoral priorities in the light of evolving PA development programmes; an overly expeditious shift from grant to loan-financing; and, unduly optimistic expectations regarding the phasing-out of recurrent cost-funding, especially for the PA central government expenditures and police salaries. Improved functioning of PA institutions has already been noted by donors. Coupled with enhanced donor-recipient coordination through the AHLC and the Local Aid Coordination Committee (LACC), this should help to address these and related problems. An important role in this respect has been assumed since 1994 by the United Nations Special Coordinator in the Occupied Territory (UNSCO). UNSCO has established a number of priority sectoral groups, closely linked to LACC mechanisms, with a view to

ensuring an integrated United Nations involvement in the international aid effort. Along with the ongoing programmes of the United Nations Development Programme (UNDP) and the United Nations Relief and Works Agency for Palestine Refugees in the Near-East (UNRWA), these arrangements are expected to enhance the delivery of assistance by United Nations agencies and to provide competent channels for donor finance.

B. Economic performance: major trends and developments

18. Despite the growing importance attached to economic development in the Palestinian territory, reliable and coherent data on actual economic performance have rarely been so scarce and inconclusive. The gap in the statistical base on the Palestinian economy has grown since the intifada, as data collection by the Israeli authorities had been hampered and increasing resort made to aggregate estimation techniques. Since then, alternative Palestinian estimates acquired greater credibility, though wide disparities remained between Israeli, Palestinian and international accounts of Palestinian economic conditions and performance. As of 1993, the authority for statistical activities in the territory was gradually being assumed by the new Palestinian Central Bureau of Statistics (PCBS). The PCBS has made a promising start in establishing a comprehensive Palestinian statistical system the outcome of which could remedy many of the gaps and discrepancies in Palestinian socio-economic data. 18/

19. In the absence of reliable data, most observers concur that the recent performance of the Palestinian economy, especially in the first half of 1995, has continued to exhibit the major structural and cyclical problems featured for many years. 19/ The expected economic benefits of the peace process, in terms of increased employment, income and investment, have been slow to materialize into new economic realities, and standards of living have fallen sharply. 20/ In the short period that has elapsed since 1993, domestic economic growth has not yet been able to respond to the new policy environment and opportunities in a sustained or coherent manner. The productive sectors of the economy remain fragmented and poorly articulated, sensitive to external shocks and erosive forces. The structure of aggregate demand exhibits sustained imbalances and resource gaps as the Palestinian economy cannot readily readjust to the changed external circumstances. While the domestic economy has shown the potential for diversified production and growth, a legacy of deficiencies continues to stem its revival and sustained growth.

20. The only quantitative indications of aggregate economic performance until 1994 remain those provided by the Israel Central Bureau of Statistics (ICBS). 21/ ICBS estimates indicate that the gross domestic product (GDP) grew in 1992 and 1993 at an average annual rate of 12 per cent in the West Bank and 15 per cent in the Gaza Strip, followed in 1994 by a growth rate of 20 per cent in the West Bank, reflecting that year's bumper olive crop. Data are not available on GDP excluding this cyclical factor, nor on the Gaza Strip, which in the past has accounted for one quarter of the territory's GDP. On the basis of an historically high 4.5 per cent annual rate of population growth in 1992 and 1993, ICBS has estimated that per capita GDP grew annually by 7 per cent and 9 per cent in the West Bank and Gaza Strip,

respectively. Estimates of per capita income in the Gaza Strip range from $1,400 in 1993 according to ICBS, 22/ and to $900 in 1994 and $500 in 1995 according to international observers. 23/

21. Alongside indications of domestic economic growth in 1992-1994, the role of external markets (especially Israel) in supplementing domestic product and income remains paramount. In particular, factor income earned by Palestinians working in Israel has in the past accounted for 25 to 30 per cent of the combined Palestinian gross national product (GNP) and slightly more in the Gaza Strip alone. Closures of the territory in 1993 and again in 1995 have taken a toll not only on Palestinian external trade, but also on vital factor income from work in Israel. This source of income has been further constrained by the sharp fall since 1993 in the number of Palestinians working in Israeli agriculture and construction sectors, which shifted to reliance on imported foreign labour from east European and south-east Asian countries. Whereas some 120,000 Palestinians worked in Israel before 1988, this number decreased steadily to under 50,000 by 1994. By mid-1995 after the partial lifting of the closure, no more than 30,000 Palestinians had permits to work in Israel. 24/ During the periods of total closure in 1995, the Palestinian economy was estimated to be losing some $30 million per month in factor income. 25/ As compared to a monthly net factor payment flow to the territory of over $60 million in 1987, this source of income had been halved by 1994, and was reduced further until mid-1995. 26/

22. Owing to the continued inability of the domestic economy to absorb significant increases in labour supply, an immediate corollary of reduced income from labour in Israel has increased domestic unemployment, and hence further falls in disposable household income and consumption expenditure, especially in the Gaza Strip. Estimates of unemployment rates continue to diverge between different sources, reflecting definitional and statistical discrepancies. ICBS estimated unemployment in the West Bank in 1994 at 8 per cent, compared to recent Palestinian estimates of between 40 and 47 per cent in the West Bank and 55 to 58 per cent in the Gaza Strip. 27/ Depending on whether or not workers have access to work in Israel, international sources estimate the unemployment rate at between 11 and 30 per cent in the West Bank and between 17 and 33 per cent in Gaza. 28/ Public works programmes in the Gaza Strip have helped to absorb some of the idle labour force, and preparations are under way for the establishment of border industrial zones geared, inter alia, to job creation. However, the immediate impact of the unemployment situation remains critical and immediate programmes for short-term employment generation in the territory are a top priority for economic, social and political reasons.

23. The predominant primary sector, agriculture, remains sensitive to cyclical fluctuations arising from the biannual olive crop. It has continued to face volatile domestic and external markets and a lack of clear policy guidelines or market signals regarding medium-term prospects for structural transformation and internal reform. Thus, increases in agricultural output or productivity are not readily translated into consolidated economic gains and the prospects for this vital sector remain precarious. In particular, barriers to trade during the 1994/95 season created unprecedented surpluses and spoilage of farm produce, further discouraging agricultural investment, expansion and development.

24. Secondary sectors, especially the manufacturing industry, have exhibited new potentials for contributions to domestic output and to intersectoral articulation (both backward and forward linkages). However, investment in these areas remains tentative and limited, with a marked preference for speculative activities, rapid turnover and minimal risk (see section C below). Subcontracting links with Israeli industry have rendered many small and medium-sized manufacturing enterprises especially vulnerable to the impact of border closures with Israel, their major source of raw materials and market outlet. 29/ Consumer demand has been depressed by the steep decline in disposable income since the closure of the territory and the cost/price structure of many consumer and basic goods has been distorted owing to supply-and-demand constraints. Prices of imported goods, such as flour, sugar, cement, iron and animal fodder, have risen by 150 per cent or more; prices of local products have reached unprecedented lows. 30/

25. Therefore, the potentially dynamic role of Palestinian manufacturing industry has yet to be realized in the current circumstances, leaving the bulk of domestic output originating in the construction and services sectors. Construction activity has been especially favoured, owing to the pressing housing shortage and the relative facility and security associated with residential investment. New social overhead investments (sewage, waterworks, roads, public buildings, etc.) have been initiated in the light of available international aid, the need for infrastructure rehabilitation and the immediate job-creation benefits that may be realized through public works. Palestinian services have shown greater flexibility and versatility in accommodating new opportunities and turbulent market conditions, with divergent growth since 1993 in some branches of distributive, producer, social and personal services compared to stagnation in others. 31/ In accordance with past trends, growth of the services sector in the Palestinian economy has been an alternative to industrial growth, rather than one of its consequences, corollaries or even causes.

26. An issue that has been a major preoccupation since 1994 is the performance of Palestinian external trade. While recent policy developments promise new opportunities for Palestinian exports and diversified sources for imports, most technical and administrative arrangements needed to facilitate this process were still not operative by mid-1995. Palestinian external trade remained hampered by a number of factors which began to be alleviated only in June 1995. These include: poor services to support Palestinian exports to European and new markets; the slow finalization of new trade accords with Israel, Jordan and Egypt which encouraged a continuation of the pre-1993 status quo; the delays encountered in establishing mutually acceptable security, clearance and transit arrangements between the territory and Israel and with external markets; and, the impact on trade of border closures which affected Palestinian exports to Israel, imports and exports through Israel (to Arab markets and abroad) and internal trade between the West Bank and Gaza Strip.

27. According to data available on trade flows in the period, merchandise imports to the territory from Israel in 1994 dropped by 20 per cent to $815 million, while Palestinian merchandise exports to Israel dropped by 25 per cent to $130 million. 32/ As a further indication, at the height of the closure up to 1,000 containers with goods imported from abroad through

Israel and destined for the Palestinian territory were reported to be stranded in Israeli seaports awaiting the reopening of the borders. 33/ Hundreds of trucks of goods imported from/through Egypt were unable to enter the Gaza Strip in the same period and exports of Gaza citrus and vegetables were held up at the height of the season, including goods subject to free-trade arrangements with Israel.

28. Until 1995, the scale of decline in Palestinian export flows to Jordan and Arab markets are reflected in data for the entry of Palestinian agricultural goods into Jordan for marketing there and beyond. 34/ In 1987, a total of 115,000 tons of vegetables and fruits entered Jordan from the occupied territory. By 1993, only 16,000 tons of Palestinian fruits and vegetables entered the Jordanian market, though exports of citrus fruits from the Gaza Strip to Arab markets in the Gulf grew to 44,000 tons. In 1994, only 6,400 tons of fruits and vegetables from the territory were marketed in Jordan, while exports of Gaza citrus to Arab markets maintained their previous level. This transformation of Palestinian export trade with traditional markets represents in part the continuation of a declining trend that began in the early 1980s, influenced by external market conditions and local production, supply and cost factors, as well as inadequate marketing facilities. In recent years, the trend also reflects political considerations, and the entry of more competitive imports to Arab markets. Alongside efforts to establish Palestinian manufactured products in export markets, attention should be paid to the need to restore the once preferred status of Palestinian agricultural exports in Arab markets.

C. Salient features of private investment in the Palestinian economy

29. As noted, the international programme of aid to the Palestinian territory is focused on rehabilitating debilitated infrastructure, while rejuvenation of Palestinian economic sectors is generally conceived to be the obligation of the private sector, both in terms of capitalization and management. This has been a fundamental benchmark of the economic policy of the Palestinian leadership, as expressed in the Palestinian Development Programme (PDP), which envisions a dominant role for the private sector in spearheading development efforts. This section of the report summarizes the main findings of a secretariat study on private investment in the territory aimed at, inter alia, providing substantive background to the UNCTAD programme of technical assistance activities in support of Palestinian trade and investment (see Part III). 35/

1. The new policy framework for private investment

30. International interest in the economic dividends of the Middle East peace process has entailed significant developments in the policy environment bearing on private-sector development. These were initially prompted by Israeli policy liberalization towards Palestinian economic development since 1991, covering business-licensing procedures, foreign trade-clearance regulations, taxation policies and security measures affecting the investment climate. The Palestine-Israel accords of 1994 paved the way for further fundamental changes bearing on such major issues as trade, taxes, finance, labour and overall management of the local economy. While the positive

developments since 1993 have inspired hope and the interest of the business community and the general public, several factors have adversely influenced the investment climate (see section A above).

31. The overall legal framework governing economic activities in the territory has yet to be subjected to comprehensive reform. The existence of different legal systems which have not been harmonized or modernized, pose complications in the commercial field, especially in such areas as company formation, registration, licensing procedures and taxation. Laws governing investment in the West Bank consisted until recently of the 1967 Jordanian Encouragement of Capital Investment Law and Israeli Military Orders 1342 and 1055 (also applied to the Gaza Strip). The PA has recently approved an Investment Encouragement Law, which provides a range of tax concessions and relaxed regulations in regard to the transfer of accrued profits. 36/ The Law is concise and specific, and it covers projects in all fields with equal treatment for investors of all nationalities. The Law introduces guarantees against nationalization, expropriation and requisitioning. Tax incentives include import tax and corporate income-tax abatement, in conjunction with tax incentives for the use of Palestinian labour. The Law creates a complex range of benefits and eligibility requirements, depending on levels of capitalization. Tax holidays for two to five years are given to approved investment projects depending on their capital size and employment capacity. The transfer of the foreign-exchange equivalent of profits and the capital of non-Palestinians is equally guaranteed. The Law has established an inter-Ministerial Investment Commission to administer its provisions, with wide discretionary powers.

32. The Israel-Palestine accords have provided an opportunity to rebuild and expand the inadequate financial system in the territory. The development of the financial system requires significant reform with a view to encouraging the entry of new institutions, expanding existing ones, promoting competition, instilling confidence in the financial system, and improving financial intermediation. The PA has taken some initial steps in this direction, and has successfully concluded negotiations with Jordan over the issue of money and banking. The agreement is fully consistent with the Basle Concordat, and furnishes clear rules for existing banks in the territory. Another reform measure enacted was the establishment of a Palestinian Monetary Authority (PMA), which will play an important role in allaying uncertainties regarding banking regulation and supervision. Although the PMA has instilled some confidence in the Palestinian financial system, it has yet to participate actively in regulating or supervising banking, except for licensing new bank branches in the Gaza Strip and Jericho. These two measures, coupled with the December 1993 agreement between the Bank of Israel and the Central Bank of Jordan, have contributed to the liberalization of the banking climate.

33. There is no security exchange market (SEM) in the Palestinian territory, and none of the related laws or regulatory institutions that is usually to be found in a growing modern economy. The issuance and transfer of shares in public corporations is still covered by the Jordan Companies Law of 1964, for companies registered in the West Bank, and by the Palestine Companies Law of 1929 for companies registered in the Gaza Strip. Neither law applies to those securities, which are traded informally or through the offices of respective companies. Since there is no formal market, there are no statistics on the

number or value of shares traded, but it appears that the volume of this trade is very small. There are no provisions for custodial services, and the limited financial information published appears only when firms publish their final accounts. Recent political developments have prompted some investors to examine the idea of establishing an SEM in the territory. They are encouraged by the oversubscription of newly registered firms, indicative of both high liquidity and the scarcity of dinar-denominated investments.

2. Institutional, technical and related capacities

34. Chambers of commerce were established in the West Bank and Gaza Strip before the onset of Israeli occupation, in accordance with relevant local laws, but their functions and impact have been minimal. Their potential role has undergone a major change during the past few years, following elections to chamber boards of a new generation of young, highly motivated local business leaders. Chambers of commerce are increasingly engaged in a variety of functions aimed at serving the local business community. They are recognized by most foreign donors, trade delegations, financial institutions, business firms and investors, and, as such, have assumed the authority of issuing certificates of origin for the export of Palestinian goods to international markets. The new circumstances permit chambers of commerce to play an important intermediary role with relevant PA institutions and in further facilitating international trade.

35. Most standard notarial and related legal services are performed by offices located in the major towns in different districts, affiliated in the West Bank to the Israeli Civil Administration (CIVAD) and in Gaza and Jericho to the PA. As the division of authority between the various areas in the territory has not yet been clearly demarcated, new firms may have to register separately with CIVAD and with the PA in Jericho and in Gaza. Accounting offices in the territory have over the years accumulated experience in settlement of tax cases with the authorities. However, they lack expertise in other services, such as auditing, accounting and financial management. Accounting and auditing standards are yet to be modernized to provide relevant and accurate information for both management and investors. Recent developments have prompted international accounting firms to enter the local market and encouraged efforts by the PA, academics and practitioners to modernize, standardize and regulate the accounting profession.

36. Post-1993 expansion of banking in the territory has introduced more competition to the local financial market and broadened the access of Palestinians to traditional banking services. The growing number of banks in the territory should enhance competition, and improve the quality and broaden the range of financial services. It should also improve the access of a larger spectrum of the population to banking services, which in turn leads to more effective financial intermediation. However, there are still impediments to the development of this sector, thus leaving much room for improvement. Banks are small, heavily restricted, confronted with an uncertain economic climate and weak in internal management. Delays are noted in standard personal banking operations, and non-traditional services, such as personal investment management, business consultancy, credit card provision and stock underwriting are limited.

37. Local banks are widely perceived as pursuing overly conservative loan policies, coupled with the small total volume of deposits at their disposal. This reflects, inter alia, the restrictions on their operations arising from the complex interim nature of present legal arrangements. Moreover, while the supply of savings may be declining and, therefore, the cost of credit rising, there are indications of excess demand for credit. Informal banking mechanisms are numerous, but they are too small, fragmented and unregulated to fill the gap. None of the premiums paid for insurance (mainly to Israeli firms) was invested locally, but insurance activity has started to pick up since 1993, and coverage of companies involved in reconstruction projects is expected to contribute to growth in the insurance market and improved financial intermediation.

38. The Palestinian private sector has operated for many years without access to modern market information facilities, including a lack of external market information and related computer-network services. Foreign consulates were not adequately equipped to perform ordinary commercial attaché functions. In addition, a poor level of market information has accompanied a deteriorating level of English among the business community, which for many years found its interests best served by mastering Hebrew. Market information gaps also are observed in local markets, particularly in wholesale markets for farm produce, where price differences arise owing to poor intramarket communications. Modes of advertising and promotion have evolved in ways which conform with the overriding economic and political constraints imposed on the private sector. In the absence of local television and radio stations, the main promotion forum used by the business community has been local newspapers. Recently, the scope for advertising has widened with new opportunities in Jordanian media and in new local commercial and official television, radio stations, newspapers and periodicals.

39. For most Palestinian small family-based firms, business advisory services are not deemed essential and there have been no professional firms providing this service. However, the need for this service has grown during the past two years, prompting the establishment of such firms. The overall perception among senior business leaders, especially those based outside, is that the professional level of most firms is inadequate, at least when compared with international standards. Some banks and leading investment firms have opted to set up their own business advisory units, which also provide services to other parts of the business community.

40. The Palestinian private sector in the territory has always been seriously handicapped by the level of management prevailing in business enterprises, a factor which is reinforced by the family nature of many enterprises. Although most managers exhibit technical and managerial deficiencies, especially in skills required in international trade, they have developed remarkable survival skills by operating under adverse circumstances. Palestinian enterprises have acquired profound experience in the Israeli economy and business sector, an important asset in the context of regional economic cooperation. The management training needs of the private sector have broadened during the past two years. Banks, transnationals and development aid institutions have commenced by recruiting senior staff from abroad for their newly established offices in the territory. Local managerial deficiencies have spurred an influx of training facilities sponsored by non-governmental organizations (NGOs), the PA and universities.

3. Private investment flows

41. Investment flows in the Palestinian territory are derived from three main sources, namely, public-sector institutions, the enterprise sector and households. The first source has been of minimal significance, amounting to around 15 per cent of gross domestic capital formation (GDCF) until 1993. Corporate savings were also negligible, due to the unfavourable investment climate. The household sector has played a central role as a source of private investment, accounting for around 85 per cent of GDCF. Family ownership of enterprises has frustrated the establishment of full-fledged corporations or modern capital markets, a feature of investment which has impeded growth and modernization of firms, especially in the industrial sector.

42. Disaggregated data have not been available on the composition of GDCF since 1967. However, Israeli data indicate that around 85 per cent of fixed GDCF went into construction, primarily in housing. The share of construction in GDP is estimated at just below 20 per cent, which is notably higher than in neighbouring Arab economies (at 5 per cent or less in Egypt, Jordan, Lebanon and Syria). 37/ This is precipitated by a number of factors, such as the high priority given to the ownership of the family home, an acute and rapidly worsening housing crisis, increased savings accruing from rising income until 1986 and absence of alternative venues for investment. Construction accounted for 81 per cent of aggregate private investment during the 1968-1991 period, while the balance of private investment covered machinery, transport and other types of equipment. Investment in capital stock has not kept pace with depreciation, hence resulting in decreasing capacity utilization. The reluctance to modernize productive assets has been prompted by limited market potential and poor banking facilities. Private-sector firms are preoccupied with minimizing overheads and operating costs, even those invested in human resources. Such forms of adjustment have come to bear adversely on quality and cost-competitiveness.

43. Private-investment flows were expected to grow significantly following the Israel-Palestine accords. Motivated by hopes for profits and encouraged by major political developments, thousands of expatriate Palestinian and foreign investors have visited the Palestinian territory since 1993, most for the first time, in search of investment opportunities. The influx of visiting investors cuts across a wide range of nationalities, but most were diaspora Palestinians. There are no data available yet on the tangible outcome of the recent private-investment euphoria, but indications are that the volume of new private investment, which has actually reached the territory during the past two years, has been small. However, convinced that the future seems to hold promise, many new investors have proceeded to prepare the organizational and logistical infrastructures needed once conditions are appropriate.

44. The influx of new business institutions includes a wide range of firms, such as banks, insurance, construction, services and general trading enterprises. A leading investment enterprise was established in 1992 by a conglomerate of diaspora Palestinian individual and institutional investors, with an initial share capital of $200 million. In order to attain maximum efficiency in its operations, the parent corporation has established three subsidiaries catering to construction, tourism and industry. Many projects

are planned and some have commenced in construction, industrial zones and tourism; new ventures are contemplated in electricity generation, telecommunications and construction and management of export-processing zones. This corporate model is being duplicated by a number of similar holding companies which have been established during the past two years, owned and financed largely by expatriate Palestinian investors, with tangible input and participation from the domestic business community.

45. The demand for new construction has gained considerable momentum during the past two years, not only to meet the pressing housing needs of the inhabitants but also as a consequence of the influx of diaspora Palestinians, and the sudden inception of PA institutions, NGOs and donor agencies, all in need of office premises. There are projections of still greater demand in the near future. As a net outcome to present and anticipated shifts on the demand for buildings, the price of real estate and rent levels have soared during the past two years. These prices are also partly a result of distortions in the market for housing inputs, as well as of restrictions on expansion within and outside municipal boundaries.

46. Despite operating with Israeli firms since 1967, Palestinian enterprises had refrained from establishing full-fledged joint ventures with Israelis that involved sharing capital and management. Until 1993, Palestinian public opinion considered such joint ventures to represent an advanced stage of normalization of relations with Israel, which had not been possible until then. But since 1993, the Palestinian attitude to joint ventures with Israelis has shifted. The Palestine leadership has recognized joint ventures with Israel, both at the commercial and public-sector levels, as integral components of the peace process. While still cautious, Palestinian businessmen are well aware of the potential gains accruing to joint ventures with Israeli neighbours, which aim to capitalize on existing complementarities and areas of cooperation.

47. Further improvement of the investment climate in the territory calls for a range of reforms in macroeconomic and trade policies of the emerging Palestinian economy. These need to be accompanied by measures aimed at upgrading the proficiency of a range of public- and private-sector institutions that cater to private-sector development. The ability of the Palestinian economy to absorb a relatively substantial inflow of investment at an acceptable rate of return is also heavily contingent on introducing major sectoral transformations in the domestic economy. Such transformations are deemed essential if the Palestinian economy is to adjust efficiently to the consequences of freer international trade while reducing vulnerability to exogenous shocks. Accordingly, a range of policy, institutional and structural adjustments are envisioned to improve the role of private investment in Palestinian economic development. 38/

Part II

PROSPECTS FOR SUSTAINED DEVELOPMENT OF THE PALESTINIAN ECONOMY 39/

48. When the PA began to exercise its functions in May 1994, the economic situation reflected disequilibria and fragmentation in all markets, coupled with a virtual collapse of the public sector. The empowerment of the Palestinian people and the establishment of Palestinian self-government promise a new beginning for the economy. Three elements are involved: redressing of an asymmetric integration into the Israeli economy; establishment of a Palestinian Authority committed to economic reconstruction and management according to national priorities; and the assurance of the international community regarding increased finance. Bearing in mind the interplay of these elements, the UNCTAD secretariat intersectoral research project has investigated the prospects for sustained development of the Palestinian economy over the period 1990-2010. Part II reviews the major findings emerging at the macroeconomic and intersectoral levels, in particular, the macroeconomic imbalances and sectoral disarticulation, as well as the policies required to correct them.

A. The tasks of independent Palestinian economic development

49. Part One of the intersectoral project analysed the main features of the inhospitable economic environment created under the occupation since 1967, with the purpose of identifying the present characteristics of the Palestinian economy and the elements of a rehabilitation and reconstruction strategy. 40/ The following four features of the pre-1993 period appear to have had the most significant effects on the economy: restrictions on the use of natural resources, on the activities of the productive sectors, and on trade; and resource transfers to Israel and the neglect of the public sector.

50. The cumulative impact of these policies has been to weaken substantially the traditional productive sectors of the Palestinian economy, featuring two growing macroeconomic disequilibria: a resource gap and a labour market imbalance, and a growing dependence on external sources of income. The resource gap is manifest in an import surplus as well as in an investment-saving imbalance. The mirror image of the resource gap is the imbalance in the labour market, between a growing supply of labour and a limited capacity for employment in the domestic economy. The latter is reflected in the number of Palestinians employed in the Israeli economy and abroad and in the high level of domestic unemployment.

51. At present, the PA faces two challenges that require immediate action with implications for the success of long-term development efforts: building new institutions for Palestinian civil administration and rejuvenating the existing ones; and dealing with unemployment. In tackling these two tasks, the PA is expected to resist the temptation to which many newly independent countries have succumbed, namely to embark on a programme of creating institutions aimed primarily at employing people directly. Instead, the two problems should be dealt with in terms of the imperatives inherent in the reconstruction programme. Institution-building and alleviating unemployment should be directed towards expanding the capacity of the private productive

sectors. Priority should be given to activities that satisfy the double requirement of generating productive employment, while expanding the infrastructure supporting the private sector.

52. Accordingly, among the most important projects will be those which increase agriculture resources. These include programmes of land reclamation aimed at augmenting the area suitable for cultivation, increasing the supply of water by renovating artesian wells, drilling new wells and constructing reservoirs. Meanwhile, stimulating industrial activities requires increasing the supply of electricity, improving transport facilities and making large investments to enhance communications. Finally, improving and modernizing the education and health systems will have a direct bearing on social development and economic performance in the medium and longer term.

B. Macroeconomic issues of sustainable growth

53. The UNCTAD intersectoral project has further investigated the prospects for placing the Palestinian economy on a path of rapid, sustained and independent economic development. This had been carried out at two levels. First, technical analysis provides rough estimates of the amount of external resources and the time-span required to place the economy on the road to sustainable growth. Secondly, policy proposals to reform the fiscal, financial and trade systems are evaluated in terms of the supportive environment they create with regard to making the technical results possible.

54. On the first level, a scenario analysis was employed to assess future alternatives, the findings of which were published in a study by the secretariat entitled "Prospects for sustained development of the Palestinian economy in the West Bank and Gaza Strip, 1990-2010: a quantitative framework". 41/ The framework is based on a parametric exercise and projected trends of key demographic, labour and economic variables for the period 1991-2010 under a baseline scenario and several alternative scenarios. In one alternative scenario, a programme of deliberate policy of reconstruction has been assumed. The policy components are focused on accelerating private investment, promoting exports, rationalizing imports by substitution rather than by compression, switching demand from consumption towards investment and expanding government consumption and capital expenditures. As a result of this programme, unemployment is projected to decline significantly and improvements are noted in the resource gaps. External aid and investments are crucial to these achievements, though with a declining trend over time. To ensure that the economy will, in fact, show this kind of positive response to growth-enhancing activities, macroeconomic policy changes are called for, including reforms in fiscal, financial and trade policies.

55. The success of this programme for the reconstruction of the Palestinian economy is dependent on external aid, as national savings are currently not large enough to finance infrastructure rehabilitation, and exports are not adequate to supply the needed foreign exchanges. On the other hand, external aid is by its very nature a temporary remedy, and its success can be measured by the extent to which the economy is stimulated to grow and create its own replacement by increasing national savings and exports. As such, part of the growing income must be saved, part of the growing output must be exported and

the rates at which investment and exports grow must outpace those of consumption and imports. Consequently, there is a need for two sets of macroeconomic policies. First are the policies related to the supply side, to create the incentives to increase savings and ensure their optimal allocation among different investments. Secondly, are the policies on the demand side, operating to constrain both inflation and increasing prices of non-tradables relative to tradables.

56. At present, the public finance system is characterized by overtaxation and underspending. Palestinians have been paying too many taxes and too much in taxation, while the share of GNP devoted to public expenditure represented a low level of government activity. The difference between taxes and expenditures implies a "budget surplus", with an adverse impact on aggregate demand and economic growth. Furthermore, the structure of the tax system is not suitable for the Palestinian economy. Direct tax rates on personal incomes and corporate profits are similar to those in Israel, and the indirect tax rates (VAT) are identical, despite the differences between the two economies with regard to size, structure and, more importantly, stages of development.

57. There is, as such, an urgent need to restructure the system in accordance with the present stage of development and the needs of the Palestinian economy. Broadly, reform should concentrate on reducing the number of taxes, shifting reliance away from income and foreign trade taxes and increasing consumption-based taxation, with most taxes having flatter rates and much wider bases than at present. As for the public expenditure system, the PA needs to specify how the budget is to be formed, implemented, and controlled, in both the executive and the legislative branches of government. In the meantime, it is important to allocate expenditures according to the needs of the reconstruction programme.

58. There are now clear indications that the banking sector will be able to perform the dual role of supplying services needed in other economic activities, and of creating some growth-enhancing activities internally. During the transitional period, two currencies are to be used as legal tender - the new (Israeli) shekel (NIS) and the Jordanian dinar (JD) - and the PMA will be the national institution responsible for supervising monetary and banking activities. The PMA has many functions typical of a central bank, including the supervision of all financial institutions, acting as banker and sole financial agent of the PA, and constituting lender of last resort to commercial banks (functions which are constrained by the absence of a national currency).

59. While the monetary arrangements during the interim period represent an improvement over those of the past, they are not optimal. Indeed, the arrangements combine some of the less desirable aspects of two polar-type exchange-rate regimes. The absence of a national currency renders monetary policy ineffective, as in a fixed exchange-rate regime. The existence of a two-currency standard has the potential for increasing those costs associated with fluctuations in exchange rates typical of a flexible exchange-rate regime. In addition, a dual currency tends to reduce commercial banks' ability to perform their function of transforming debt maturities, because of the problem of currency mismatching inherent in their portfolios. This could

discourage them from extending long-term loans, which are essential for investment and growth. Regarding future monetary arrangements, five alternatives are considered: an independent Palestinian currency; the JD; a Palestinian currency in union with the JD; a Palestinian currency in union with the NIS; or a Palestinian currency in union with the JD and the NIS.

60. Parallel to reforming the public finance and monetary sectors, of equal importance is the need to revitalize, reorient and strengthen the trade sector. At present, the trade sector is both weak and deteriorating as a result of the interplay between restrictions on production and barriers to trade. Reversing this vicious spiral in a way that favours growth in trade and production requires substantial changes on three fronts: removing restrictions on the use of natural resources; increasing the ability of Palestinian producers to import raw materials, intermediate goods, and capital goods at competitive prices; and opening neighbouring markets to Palestinian products.

61. Since substantial improvements on all three fronts will require time, it would be misleading to refer to the optimality of any trade arrangements between the Palestinian economy and its neighbours irrespective of the time factor. Instead, trade arrangements should follow a sequential pattern, reflecting the degree to which the Palestinian economy has overcome the heritage of restrictions and distortions. In the long run, the optimal trade arrangement for such a small economy is likely to be close to free trade, but free trade now implies locking in some negative aspects of the present situation. The goal for Palestinian external trade in the medium term therefore should be to revive and restructure the trade sector, with the long-term goal of free trade with its neighbours. A free-trade arrangement is desirable in the long run in so far as it enables the Palestinian economy to pursue an export-oriented growth strategy, and to free itself from external dependence.

C. Major sectoral issues of structural transformation

62. The preceding review of major macroeconomic considerations leads to a focus on the sectoral issues involved in the reconstruction programme. In particular, the secretariat's research project has analysed the measures and policies required in the main sectors - agriculture, industry, construction, services and public utilities - so that the reconstruction effort advances smoothly, without the crippling effects of bottlenecks and rigidities, and results in the removal of the sectoral disarticulation that presently exists.

63. Given the current conditions, and guided by the experience of other comparable economies, improving intersectoral articulation entails enhancing the role of manufacturing in the economy. Two stages can be distinguished in the movement towards this goal, in both of which the agricultural sector plays a pivotal role. In the first stage, growth-enhancing activities may be concentrated mainly in the construction of infrastructure and in establishing new government institutions and public services. In this stage, a set of interrelated policies are called for to expand agricultural production for two reasons. First, given the relatively high proportion of expenditures devoted to food in the Palestinian family budget, a relatively high income elasticity of demand for food, and the expected increase of population due to the flow of

Palestinian returnees, demand for food will increase substantially. This has to be met by an increase in domestic supply, so that no pressure is put on the limited supply of foreign exchange and on the real wage. Secondly, given that activities for the construction of infrastructures and the establishment of public institutions cannot absorb the majority of the unemployed, it is left to the agricultural sector to play an important role.

64. A successful completion of the first stage, with most of the basic infrastructure and public services built, means that growth in the second stage will come from expansion in the manufacturing and service sectors, which in turn exerts heavy pressure on the agricultural sector. From the supply side, expansion of industrial production requires an increase in employment with relatively stable real wage rates. Both cannot be achieved simultaneously unless the productivity of agriculture increases concurrently, so as to release labour to the urban sectors and, at the same time, to increase agricultural production and maintain stability of food prices. On the demand side, given external market constraints in the short run, industrial expansion has to depend for some time on rural demand. Thus, an increase in agricultural productivity is essential to increase rural income and, in turn, the demand for industrial products.

65. As noted in previous secretariat reports, underlying the stunted development of the agricultural sector and shifts in production patterns over past years are an interlinked set of policy restrictions and resource constraints. The gradual removal of these restrictions and constraints is essential to revive the agricultural sector and to allow it to perform its role in the two stages of the reconstruction programme. The major changes called for include: agriculture planning policy and institutions to establish facilities in the marketing, extension and supporting systems, and to plan for the future; land-management policy for both irrigated and rainfed land; water-management policy to increase the supply and efficient use of water; improved agricultural marketing facilities and coordination; development of human resources, especially entrepreneurial and managerial; and agriculture education in colleges and in centres of agricultural research.

66. Together with agricultural reform, it can be expected that the removal of restrictions affecting the manufacturing sector, and the revival of the financial sector, supplying both financial intermediation and risk management, will stimulate increasing industrial activity. However, a major transformation, whereby its contribution to GDP, trade, and employment increases substantially, will require an active role for the public sector, including: building the necessary infrastructure in transportation, communications and electricity, and supervising the establishment of industrial zones; improving human resources by allocating more finance to technical and vocational institutions; developing the legal and institutional framework within which foreign investment is encouraged, and induced to transfer technology, train local labour and increase industrial exports; encouraging the creation of a support system that can supply industrial enterprises with long-term credit for investments, information regarding foreign markets and technical advice.

67. The poor natural resource base, and the small size of the Palestinian economy make export-oriented activities the appropriate medium for the long-term development of the industrial sector. In the short run, however, there is an important role for import-substitution. These activities should be encouraged in precisely those areas where domestic production could replace imports without protection and become competitive as a result of removing prevailing restrictions and of the emergence of a public support system. These activities will be mainly in agro-industry products and will have a stimulative impact on growth and employment of the whole economy owing to their strong link with agriculture and their labour-intensiveness.

68. The current situation in the housing market arises from a severely restricted supply coupled with a continuous increase in demand. To meet the expected increased demand for housing in coming years through increased supply rather than prices, there is an urgent need to formulate a housing strategy, with the aim of correcting existing distortions, as well as providing an adequate delivery system with a more equitable distribution of resources and benefits. The formulation and execution of the housing strategy will be a formidable task owing to the fact that housing in the territory has had no public role during the last 28 years. It should include the following elements: adopting a plan of urban expansion taking into account the prevailing population densities in different regions, their potential economic expansion and their need for residential infrastructure; removal of the market distortions in building materials, by encouraging domestic production and importation at competitive prices; reviewing all laws related to property rights and rent control; and establishing a finance system for housing, covering all social categories.

69. The Palestinian services sector will play a dual role in the reconstruction programme. It will generate much growth, tapping the potentials in many branches, including finance, tourism and the range of producer and distributive services of the private sector. Equally important is the role of services in facilitating growth in other sectors. Communications, transportation, retail trade, banking and insurance services are essential to the growth of agricultural and industrial production, trade, and foreign investments. Given the historical and religious significance of Palestine, tourism has the potential for substantial growth. The transformation of tourism into modern industry, however, requires major improvements in transportation, hotels, restaurants, human resources, and tourist-related industries. Meanwhile, development finance, communications, transportation and retail trade require an educated labour force. Essential to the reconstruction of the four main sectors is a substantial improvement in public utilities. Investment priorities may be identified in the following branches: water, energy, sanitation, public markets and public safety.

70. The preceding paragraphs briefly reflect sectoral priorities along with policy guidelines for action which are intended to help in the elaboration and achievement of the objectives of Palestinian reconstruction. This should aim at developing the Palestinian economy in a manner which employs the labour force, diversifies trade and achieves an adequate rate of growth in per capita income. It would be coupled with a more equitable distribution of the benefits of growth and development among regions and individuals, within

the context of eliminating external economic dependency through building close relations with all neighbours. Achieving these objectives requires: articulating the reconstruction programme through a comprehensive set of economic policies; changing the legal system governing economic activities; creating many new public institutions to regulate and supply support services to the private sector and building infrastructures; and embarking on a programme to improve productivity. These broad avenues constitute an intersectoral framework for action and reform.

Part III

REVIEW OF PROGRESS IN THE WORK OF THE UNCTAD SECRETARIAT ON ASSISTANCE TO THE PALESTINIAN PEOPLE, 1994-1995, WITH SPECIAL REFERENCE TO THE PROGRAMME OF TECHNICAL COOPERATION ACTIVITIES

71. During the period under review, the work of the secretariat was largely focused on contributing to efforts aimed at building up Palestinian institutions and their technical capabilities in policy-making and management of the economy. To this effect, activities were concentrated on: (a) monitoring of developments in the economy of the West Bank and Gaza Strip; (b) undertaking policy-oriented research on priority areas/issues of the Palestinian economy, including the finalization and issuing of a number of sectoral studies prepared within the frame of the intersectoral project on prospects for sustained development of the Palestinian economy; (c) finalizing the proposed programme of technical assistance to the Palestinian people in areas of UNCTAD's competence; and (d) coordinating activities with the related efforts of the international community through the recently established coordinating mechanism of the United Nations system. In carrying out these activities, close consultations were held with Palestine, the relevant substantive organizations of the nascent Palestinian Authority (PA) and other bodies concerned.

A. Monitoring of recent developments in the Palestinian economy

72. Work in this area was focused on the impact of the new policy environment that has emerged since the signing of the Declaration of Principles and the economic accords between Israel and Palestine empowering the Palestinian people in a number of economic and social sectors in their territory. Emphasis was particularly directed to the implications of the economic accords between Israel and Palestine, the emergence and consolidation of a central Palestinian Authority, the extent of international assistance aimed at supporting national Palestinian efforts to revive the economy, and to developments in key areas of the economy. Attention also has been directed at factors affecting private investment in the Palestinian territory.

B. Policy-oriented investigation of priority areas/issues

73. In this area, the work of the secretariat was guided by two considerations: (a) to provide supportive substantive analysis for the formulation and management of policies and action programmes by the PA and the international community in priority areas of the economy; and (b) to examine prospects for the long-term development of the Palestinian economy.

74. Accordingly, a number of selected studies prepared within the context of the intersectoral project were finalized and published during the period under review. These comprised: "Population and demographic developments in the West Bank and Gaza Strip until 1990" (UNCTAD/ECDC/SEU/1); "Public utilities in the West Bank and Gaza Strip" (UNCTAD/ECDC/SEU/2); "Health conditions and services in the West Bank and Gaza Strip" (UNCTAD/ECDC/SEU/3); "Construction and housing in the West Bank and Gaza Strip" (UNCTAD/ECDC/SEU/4); "Main features of domestic and external merchandise trade of the West Bank and Gaza Strip" (UNCTAD/ECDC/SEU/5); "Prospects for sustained development of

the Palestinian economy in the West Bank and Gaza Strip, 1990-2010: a quantitative framework" (UNCTAD/ECDC/SEU/6) and its "Technical supplement" (UNCTAD/ECDC/SEU/6/Add.1); "Developments in the services sector in the West Bank and Gaza Strip, 1967-1990" (UNCTAD/ECDC/SEU/7); "Environment and development prospects in the West Bank and Gaza Strip" (UNCTAD/ECDC/SEU/8); and "Review of labour and employment trends in the West Bank and Gaza Strip" (UNCTAD/ECDC/SEU/9). A number of additional sectoral studies selected for publication are being finalized and will be issued before the end of 1995. These deal with socio-economic statistics, education, public finance and private investment.

75. As regards the long-term prospects for development of the Palestinian economy, the main study initiated in 1994 and aimed at consolidating Parts Two and Three of the intersectoral project is nearing completion. The salient features of the study covering future prospects, strategies and policy guidelines for the long-term development of the Palestinian economy are outlined in Part II above.

C. Programme of technical cooperation activities

76. Following the formulation of its proposed programme of technical cooperation activities in support of the efforts of the nascent PA, the UNCTAD secretariat held consultations with the Palestinian Authority on the priorities, scope, orientation and implementation modality of the programme. 42/ The Israeli authorities were first approached in October 1994 with a request to allow the secretariat staff access to the Palestinian territory. On granting such access in March 1995, arrangements were immediately made to send a mission to the West Bank and Gaza Strip. Accordingly, consultations were held with officials of various ministries of the PA, the UNDP in the Palestinian territory, and the office of UNSCO, as well as with a number of other parties concerned. Consultations were also held with the officials of Palestine and PECDAR in Tunis on various aspects of the proposed programme, including possibilities of its funding from bilateral and multilateral sources.

77. Pursuant to these consultations, the proposed programme has been further developed and finalized and a follow-up secretariat mission to the territory was undertaken in May 1995 for substantive consultations on issues related to private investment. The main thrust of the programme is to provide support to the efforts of the Palestinian people in the areas of trade, finance and transport. Specifically, it aims at contributing to the following interrelated objectives:

- Strengthen the technical, managerial and information capacities of the Palestinian public and private sectors institutions responsible for the formulation and implementation of policies and procedures in international trade and related fields;

- Formulate policy/strategy options to enable the Palestinian agriculture, industry and services sectors to exploit effectively emerging market opportunities at the subregional, regional and interregional levels; assist in the establishment of a Palestinian tariff regime and customs administration aimed at enhancing production and liberalizing trade;

- Enhance the capacity of the commodity producing sectors for promoting industrial activities and diversifying agricultural and manufactured exports;

- Assist in the establishment of the necessary infrastructures (legal, institutional, technical and human resource capacity) for the creation of an adequate and efficient transport system for trade, including shipping services, a commercial seaport in the Gaza Strip and multimodal transport;

- Reform of the overall legal and regulatory framework, along with institutional capacities, for mobilizing financial resources, promoting private investments and improving the performance of public utilities; and

- Strengthen Palestinian technical and institutional capacities in management of financial flows and maximization of insurance resources and their efficient allocation.

78. The range of activities envisaged for the achievement of these objectives are being costed. The proposed programme will be presented to the PA for its approval and then to potential bilateral and multilateral sources of funding to seek contributions. As this process is likely to take some time, the PA requested the UNCTAD secretariat to initiate immediate action, within the framework of the programme, regarding some priority issues in the proposed programme, which were also envisaged as part of the PA's work programme for 1995. These comprised, among others, the following issues: the legal and institutional framework for, as well as institutional and procedural aspects of, the private investment encouragement law; export-processing zones; export promotion and marketing facilities; procurement of strategic consumer commodities; trade policy in the context of the Uruguay Round and the need for reviving the Palestinian economy; multimodal transport including the development and management of the commercial seaport in the Gaza Strip. Resource limitations have not yet allowed the UNCTAD secretariat to meet the preliminary needs of the PA in all the areas requested. However, the secretariat has been able to involve the substantive divisions and programmes concerned in some of the areas. Accordingly, several missions were organized in mid-1995 to extend immediate advisory services to the PA in some of the areas requested. In addition to extending the required immediate technical assistance, these missions have also elaborated a package of feasible operational activities as a follow-up action in each area. As envisaged in the proposed programme, these packages comprise increased advisory services, training programmes and workshops, as well as short-term assignments of experts in critical areas. The secretariat looks forward to the Board's guidance and support for the funding and implementation of the programme outlined above.

D. Coordination and cooperation within the United Nations system

79. Following the designation of the United Nations Special Coordinator in the occupied Palestinian territory and the establishment of his Office to serve as a mechanism to coordinate the activities of the organizations of the United Nations system, the UNCTAD secretariat has intensified its cooperation

efforts. A meeting was held on 6 April 1995 between the Officer-in-Charge of UNCTAD and the Special Coordinator. The meeting aimed at examining the possibilities of intensifying cooperation with the Special Coordinator in areas relevant to the work of the secretariat. Given UNCTAD's broad mandate and expertise in trade and development, including such related fields as finance, investment, enterprise development, services, environment, technology and others, the UNCTAD secretariat has joined the United Nations Priority Sector Groups (PSG) on Private Sector Trade, and Institution Building. Similarly, the UNCTAD secretariat has also established contact with the focal points of sectoral working groups for local aid coordination, especially concerning the private sector, institution building and transport. In both instances, the UNCTAD secretariat deals through UNDP and UNSCO, which serve as the focal points for the substantive areas concerned. The UNCTAD secretariat has also contributed to and participated in United Nations meetings related to its work on the Palestinian economy.

Notes

1/ Unless otherwise mentioned, references in this report to the "occupied territory" or the "Palestinian territory" or "the territory" pertain to the occupied Palestinian territory (i.e. the Gaza Strip and the West Bank, including east Jerusalem).

2/ The Declaration of Principles on Interim Self-Government Arrangements (of 13 September 1993) and the Agreement on the Gaza Strip and the Jericho Area (of 4 May 1994), including its Protocol on Economic Relations.

3/ See "Developments in the economy of the occupied Palestinian territory, with special reference to external trade", TD/B/41(1)/3, paras. 5-11.

4/ Also referred to as the Palestinian National Authority (PNA), established by Palestine in October 1993.

5/ Excluding east Jerusalem, which is one of the final status issues not covered by the interim accord, and which is due to be negotiated commencing in 1996.

6/ Information provided by the Palestinian Authority, Ministry of Finance, Tax Clearance Department; also see Jerusalem Post, 28 May 1995.

7/ Ibid.

8/ Al Quds al-Arabi, 2 June 1995.

9/ See Jerusalem Post, 29 March 1995.

10/ See Jerusalem Post, 7 May 1995 and 8 May 1995.

11/ Contacts on this issue were reported to have begun in May 1995, Jerusalem Post, 22 May 1995.

12/ These framework agreements were signed on 26 January 1995, on the basis of drafts agreed in early 1994 (see TD/B/40(1)/3, paras. 16-18).

13/ Meeting of the Joint Trade Committee between the Arab Republic of Egypt and the Palestinian National Authority, Cairo, 18 and 19 April 1995.

14/ Al-Quds al-Arabi, 6 June 1995.

15/ Data quoted in this section were provided by PECDAR Office of Aid Coordination and Facilitation, in "Matrix of Donors' Assistance to the West Bank and Gaza" (December 1994).

16/ The urgency of ensuring expeditious and full aid delivery to cover both public investment and recurrent budgets was recently reaffirmed by the United Nations Special Coordinator for the Occupied Territories in letters addressed to the donor countries, reported in Ha'aretz, 14 May 1995. Also see interviews with the Special Coordinator in Financial Times, 21 November 1994 and Jerusalem Post, 1 March 1995.

17/ PECDAR, op. cit.

18/ See, "Sources of economic and social statistics on the West Bank and Gaza Strip", (UNCTAD/ECDC/SEU/10), forthcoming.

19/ See, for example, Economist Intelligence Unit, "Israel and the occupied territories, 1994-95: Country Profile", (London, Economist Intelligence Unit (EIU), 1994) and the related quarterly "Country Reports" for an impartial assessment of the economic situation in the territory.

20/ The United Nations Special Coordinator in the Occupied Territories stated in late 1994 that "the gap between expectations and delivery is so large, and unless donors get together to deliver, the peace process will fail" (Financial Times, 21 November 1994).

21/ See Jerusalem Post, 1 February 1995; Economist Intelligence Unit, "Israel and the occupied territories: country report", 1st quarter, 1995 (London, EIU, 1995).

22/ Jerusalem Post, 1 February 1995.

23/ Jerusalem Post, 29 March 1995.

24/ International Labour Office, "Report of the Director General - Appendix" (Geneva, 1995), pp. 13-14.

25/ According to sources of the Palestinian Authority and other observers, e.g. Economist Intelligence Unit, "Country report", op. cit.

26/ This situation has led to suggestions that Israel could "compensate" the Palestinian economy for a total end to import of Palestinian labour with a sum of some $300 million annually, roughly equivalent to the "revenue gap" identified as the annual income foregone as a result of the closures of the territory, in Jerusalem Post, 21 March 1995.

27/ Jerusalem Post, 14 March 1995; Economist Intelligence Unit, "Country report", op. cit.

28/ International Labour Office, "Report ...", op. cit., p. 15.

29/ A recent survey of Palestinian industries in the territory found that over 50 per cent rely on subcontracting arrangements with Israel, while 60 per cent of enterprises are dependent on markets in Israel, reported in Al-Quds, 28 July 1994.

30/ Economist Intelligence Unit, "Country report", op. cit.

31/ For an in-depth investigation of this sector, see "Developments in the services sector in the West Bank and the Gaza Strip, 1967-1990" (UNCTAD/ECDC/SEU/7).

32/ International Labour Office, "Report ...", op. cit., p. 12.

33/ Information provided by the Palestinian Authority, Ministry of Economy and Trade, May 1995.

34/ Data provided by: the Agricultural Marketing Institute, Department of Research and Studies, Amman, 1995; Gaza Strip Citrus Producers Union, Annual Report (various years).

35/ The study is to be published later in 1995 under the provisional title "Private investment in the occupied Palestinian territory: recent trends and immediate prospects" (UNCTAD/ECDC/SEU/13). The study, and the summary findings in this report, are based on the ongoing research by the secretariat on the issue and a field report prepared by UNCTAD consultant, Dr. Hisham Awartani, assisted by Dr. Nasir Abdelkarim (both of An-Najah University, Nablus, West Bank).

36/ On 30 April 1995, as published in Al-Quds, 3 May 1995.

37/ See UNCTAD Handbook of international trade and development statistics 1992 (New York, United Nations, 1993), tables 6.3 and 6.4.

38/ See Chapter IV of the forthcoming secretariat study on this issue (UNCTAD/ECDC/SEU/13).

39/ This part draws on a consolidated study, prepared by UNCTAD consultant Professor Fadle Naqib, Waterloo University, Canada, which incorporates the findings of Parts Two and Three of the UNCTAD secretariat intersectoral research project. The full study is intended for publication later in 1995.

40/ The findings of Part One of the intersectoral project have been published since 1993 in a series of UNCTAD secretariat studies and sectoral investigations. These sectoral studies have constituted the basis for developing the UNCTAD secretariat's programme of immediate technical assistance to the Palestinian people in trade, finance, transport and related areas.

41/ UNCTAD/ECDC/SEU/6 and UNCTAD/ECDC/SEU/6/Add.1.

42/ See TD/B/41(1)/3 for the details of the proposed programme.